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SUBJECT: RWE'S VIEWS ON THE NABUCCO PROJECT

11. (SBU) Summary. In a July 15 meeting with Special Envoy Gray, RWE's Chief Commercial Officer Stephan Judisch shared his views on the current progress on the Nabucco Pipeline project and the challenges he sees going forward. From Judisch's standpoint, the biggest challenge on Nabucco is lining up enough gas supplies to justify the investment and the biggest factor limiting available supply is Turkey's current desire to buy up all of the gas production from Azerbaijan's Shah Deniz Phase II. RWE is trying to convince Turkey that being tied in to Europe's 550 bcm market will guarantee security of supply for Turkey. One novel approach RWE is considering to help Turkey with its security of supply concerns is to suggest using new modern coal-fired power plants built on the Black Sea coast with a generating capacity equivalent to 6 bcm of gas-fired plants. Even if Turkey's demands can be scaled back, however, Judisch believes Nabucco will need to look beyond Azerbaijan to Turkmenistan to line up enough supply to justify Nabucco. End Summary.

12. (SBU) In a July 15 meeting with Special Envoy Gray, German RWE's Chief Commercial Officer Stephan Judisch shared his views on the current progress on the Nabucco Pipeline project and the challenges he sees going forward. The Inter Governmental Agreement and Host Government Agreements (both legislate for the transit rights through the transit countries, but are especially important for Turkey) are in draft form and currently being negotiated by the Project's shareholders with Turkey. RWE believes it is critical that these now get resolved and signed by September/October 2008. From Judisch's standpoint, the biggest challenge on Nabucco is lining up enough gas supplies to justify the investment and the biggest factor limiting available supply is Turkey's current desire to buy up all of gas production from Azerbaijan's Shah Deniz Phase II (SD-2).

#### Mitigating Turkey's Security of Supply Concerns

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13. (SBU) Turkey is worried about security of supply, despite being oversupplied during the past five years. They fear the Russians could cut off supply, and as a result Turkey is now trying to capture all the Azeri gas. If they succeed, Judisch believes there will be no Nabucco. RWE is trying to convince Turkey that being tied in to Europe's 550 bcm market will guarantee security of supply for Turkey. One method RWE is considering to mitigate Turkey's concerns is to offer them guaranteed access to Nabucco gas. Nabucco is a 30 bcm project, each of six partners has an equal 5 bcm share of the capacity, and RWE and OMV between them have 10 bcm. To help Turkey with its security of supply concerns, RWE and OMV would be willing to guarantee half of their combined share (5 bcm) to Turkey in case of a supply crunch. However, the companies would require that the "crunch" be verified by an independent body to determine if Turkey really needs it. Judisch also believes that most if not all of the other

Nabucco partners would be willing to enter in to a similar agreement. In addition, RWE/OMV have conceptually offered to set up joint venture companies with Turkish companies for the purpose of investing in the upstream and midstream gas sector in Turkey and its neighboring countries - this would also include purchasing gas, which could be used for Turkish and European markets. Turkey has to date not engaged with RWE/OMV on the proposals.

14. (SBU) Judisch views Turkey as "the big issue" and said "every day Nabucco is delayed is a day for the competitors." The Nabucco partners are continuing to work on the IGA with Turkey, and the draft is now in Turkish hands for review. The Turkish demand for a 15 percent lift-off is in the host government agreement (HGA), but Turkish officials tell RWE that Turkey would be willing to give this up. Nonetheless, in a conference call on July 14, Judisch learned the 15 percent demand was back in the agreement. Judisch does not believe Turkey will succeed in getting the deal they want. Turkey wants a net back price on the lift-off quantities, believing if the gas stops in Turkey they should get a cheaper price than if the gas goes all the way to Baumgarten. This is at odds with the view from Azerbaijan, as Azerbaijan sees no reason it should have to supply Turkey at a discounted rate when it can get a better price in Baumgarten.

#### Security of Supply through Diversity of Fuels

15. (SBU) One novel proposal RWE is considering to assuage Turkey's security of supply concerns is suggesting the construction of modern coal-fired power plants on the Black Sea coast with generating capacity equivalent to 6 bcm of gas-fired plants. These plants could be fueled from coal

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mined in the Donnets region of Ukraine, which could be shipped across the Black Sea without transiting the Bosphorus. Judisch acknowledged that the plants could also be built to use Turkish lignite (an option Judisch indicated is preferred by Turkey), but believes the lignite is of such poor quality that it would make more sense to import coal from Ukraine. According to Judisch, Ukraine has vast deposits of anthracite coal. Nonetheless, Judisch acknowledged that doing business in Ukraine is very, very difficult. (Comment: Under the EU's emissions trading scheme if Turkey did indeed build new coal-fired power plants, they might actually qualify for Clean Development Mechanism (CDM) credits as the modern plants would have less emissions than the older plants they would replace. End Comment.)

#### Azerbaijan Alone is not Sufficient

16. (SBU) Besides transit, Judisch's other big concern is supply. Judisch indicated RWE has between 15-18 months to make the final investment decision for Nabucco. To go forward, the project will require 8 bcm capacity commitments by 2013 and a further 5.5 bcm by 2015. So far the numbers don't look favorable. The only "sure" source of gas Judisch sees is from Azerbaijan's SD-2, which RWE estimates should produce 12-15 bcm of gas. Judisch indicated that between 3 and 4 bcm of the gas from SD-2 will probably be consumed domestically in Azerbaijan or exported to Georgia. That leaves 8-12 bcm for export west. If Turkey takes 8 bcm, as it is now demanding, that leaves only 0-4 bcm for Nabucco. Even if Turkey's demands can be scaled back, Judisch doesn't believe Azerbaijan alone has enough supply to justify Nabucco.

#### Looking Beyond Azerbaijan

17. (SBU) RWE is very interested in gas from Iraq but views this as a possible addition for phase two of the project. The only real possibility for Nabucco phase one is Turkmenistan. Turkmenistan is committed to sending up to 10 bcm west, but the question is "how do you get it to Turkey?" RWE sees three possible routes:

-- A Trans-Caspian pipeline, this would be the preferable option, but Judisch thinks a decision has to be made to build the pipeline within the next 15 months for it to be in time for Nabucco.

-- RWE views transit through Iran as another option. Judisch said that RWE is convinced that transit is not excluded by the current Iran Sanctions. To support his case, Judisch pointed out that the U.S. has not rebuked Turkey for buying gas from Turkmenistan, which transits Iran.

-- The third option would be to use compressed natural gas (CNG) tankers to transit the Caspian. This would be challenging, but Judisch believes it would be do-able. RWE is in discussions with both Turkmenistan and Kazakhstan about this option. Judisch plans to travel to Ashgabat to pursue the CNG option in case a Trans-Caspian pipeline isn't possible.

18. (SBU) Comment. RWE as the newest partner in Nabucco appears committed to making the project work and is pursuing some novel approaches to that end. End Comment.

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